

ALERT: Tenancy-in-Common Interests as “Securities”

It has come to the attention of the Securities Division that many real estate agents, broker-dealers, securities salespersons, and others have been selling real estate investments in the form of tenancies in common. Generally, a tenancy in common is a form of property ownership in which multiple persons each own an undivided fractional interest in the entire property. For instance, if ten investors wanted to acquire a \$1,000,000 property but each investor individually had only \$100,000 to invest, the investors could pool their individual funds and acquire the property as tenants in common, each owning 1/10 of the entire property. This form of ownership can be a feasible way to invest in real estate and, for certain repeat real estate investors, can result in favorable tax treatment under § 1031 of the Internal Revenue Code.

Tenancies in common may constitute “securities” under the “investment contract” test. In general, an investment contract exists when there is an investment of money in a common enterprise with the expectation of profits to be derived primarily from the efforts of others. In many tenancies in common, investors commit assets to a real estate acquisition by pooling funds with other investors, expecting to make profits from the entrepreneurial, managerial, or similar activities of others. Additionally, a tenancy in common may constitute a “security” under other provisions, such as the “risk capital” test.

This *Alert* reminds those offering or selling tenancy in common interests that are securities to comply with the Securities Act of Washington and the rules adopted thereunder, including requirements that:

- Such securities be registered or exempt.
- Those offering, selling, or advising investors to purchase such securities be properly licensed or exempt from that requirement.
- Those offering, selling, or advising investors to purchase such securities not engage in fraudulent, dishonest, or unethical conduct or practices.
- Investors receive full disclosure of all material information about the investment.

To determine whether a contemplated tenancy in common arrangement is a security, it is recommended that you consult with an attorney for individualized legal advice.

The National Association of Securities Dealers (NASD) has recently determined that tenancy in common exchanges generally involve securities. For more information, see NASD Notice to Members 05-18 (March 2005), available on the NASD website at http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_013455.pdf.